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Summary of the *Economic and Social Survey of Asia and the Pacific 2017*

Note by the Secretary-General

The Secretary-General has the honour to transmit herewith a summary of the *Economic and Social Survey of Asia and the Pacific 2017*.

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Summary of the *Economic and Social Survey of Asia and the Pacific 2017*

[Original: Chinese, English, French and Russian]

Summary

While the recent economic expansion of Asia-Pacific countries has been steady, it is modest compared to its recent historical trend amid prolonged weak external demand, rising trade protectionism and heightened global uncertainty. At the same time, decades of rapid economic growth, facilitated by globalization and technology, came at the expense of rising inequalities and environmental degradation. Addressing such economic, social and environmental challenges in a coherent and decisive manner will be critical for the region's future.

In view of such challenges and the 2030 Agenda for Sustainable Development, the *Economic and Social Survey of Asia and the Pacific 2017* was written with an emphasis on the importance of better governance and effective fiscal management. In particular, the quality of governance affects development outcomes through its impact on the composition and efficiency of public expenditure. At the same time, weak governance partially explains the low levels of tax revenues in several countries of the region. Governance impacts the way public revenues are raised by affecting tax morale as the willingness to pay taxes is affected by perceptions of how well tax revenues are used.

In the 2017 *Survey*, it is argued that transparency and accountability in public administration can be improved and strengthened by ensuring production of and access to key data and information, and developing public administration capacities to monitor, evaluate and audit policies and actions. Inclusive institutions, where public service beneficiaries can exchange views with the Government, could also be instrumental for raising tax revenues and making expenditures more efficient. Also highlighted are the roles of e-government, information and communications technology and decentralization in improving governance in the context of fiscal management.

The potential benefits of better governance, as highlighted in the 2017 *Survey*, are large and wide-ranging, including better health outcomes in the Pacific, economic diversification in North and Central Asia, decent jobs in South and South-West Asia, ecological innovations in East and North-East Asia and narrowing development gaps in South-East Asia.

The Commission is invited to consider the issues analysed in the present document and provide policy guidance and recommendations to strengthen governance and fiscal management in order to improve long-term economic prospects and address social and environmental concerns.

I. Introduction

1. Economic growth in Asia-Pacific economies, though steady, is modest compared to its recent historical trend amid prolonged weak external demand and rising trade protectionism. While robust economic growth is not a sufficient condition for achieving broader development goals, the lack of it could undermine poverty reduction and expansion of decent jobs. At the same time, decades of rapid economic growth, facilitated by globalization and technology, came at the expense of rising inequalities and environmental degradation. Addressing such economic, social and environmental challenges in a coherent and decisive manner will be critical for the region's future.

2. Against a backdrop of heightened global uncertainty and narrowing room for monetary policy manoeuvre, a case is made in the *Economic and Social Survey of Asia and the Pacific 2017* for a proactive role of fiscal policy to deal with these challenges through productive investments in such areas as infrastructure, social protection and resources efficiency. It is further argued that this is contingent on better and effective governance, which affects public expenditure efficiency and tax morale.

3. Better governance and effective fiscal management in the Asia-Pacific region can not only improve long-term economic prospects, but also facilitate in grappling with social and environmental concerns. Indeed, balanced progress on all three fronts is the essence of the 2030 Agenda for Sustainable Development. Governance quality, an abstract concept, has been defined to varying degrees by different organizations and institutions. In the 2017 *Survey*, political dimensions, such as democratic accountability, are avoided and governance is framed in terms of how power is exercised instead of how it is acquired. This approach respects the diversity of cultures, historical experiences and levels of development that countries in the Asia-Pacific region share.

4. A more functional definition of governance allows a focus in the 2017 *Survey* on the transmission mechanism through which governance affects various aspects of sustainable development. Specifically, the 2017 *Survey* contains an analysis of the role of governance in the mobilization and allocation of fiscal resources in order to foster development. For this purpose, governance is measured by analysing data on government effectiveness, regulatory quality, rule of law and control of corruption, four of the six worldwide governance indicators. While governance is included in the Sustainable Development Goal framework under Goal 16 by calling upon countries to build effective, accountable and inclusive institutions at all levels, it is argued in the 2017 *Survey* that achievement of this objective can also contribute to the realization of other development goals through better fiscal management.

5. The economic structure and development challenges that various Asia-Pacific subregions and economies are facing differ markedly. To reflect such diversity, a disaggregated macroeconomic analysis for each of the five subregions is provided in the 2017 *Survey*. Also presented are five selected subregional development issues which could be seen as case studies on the way in which effective fiscal policy management and good economic governance can contribute to better development outcomes. These topics build upon the argument made in the 2017 *Survey* that fiscal policy should play a more active role in addressing social and environmental concerns and that effective governance is needed to strengthen the quality of fiscal policy management and deliver impactful domestic structural reforms.

6. The five selected issues are: learning from policy experiences to promote clean energy in East and North-East Asia; diversifying sources of economic growth in North and Central Asia; using fiscal policy to improve health outcomes in the

Pacific; reducing economic informality and creating productive jobs in South and South-West Asia; and addressing binding governance issues to narrow development gaps in South-East Asia.

II. Recent economic performance and outlook

A. Economic growth dynamics

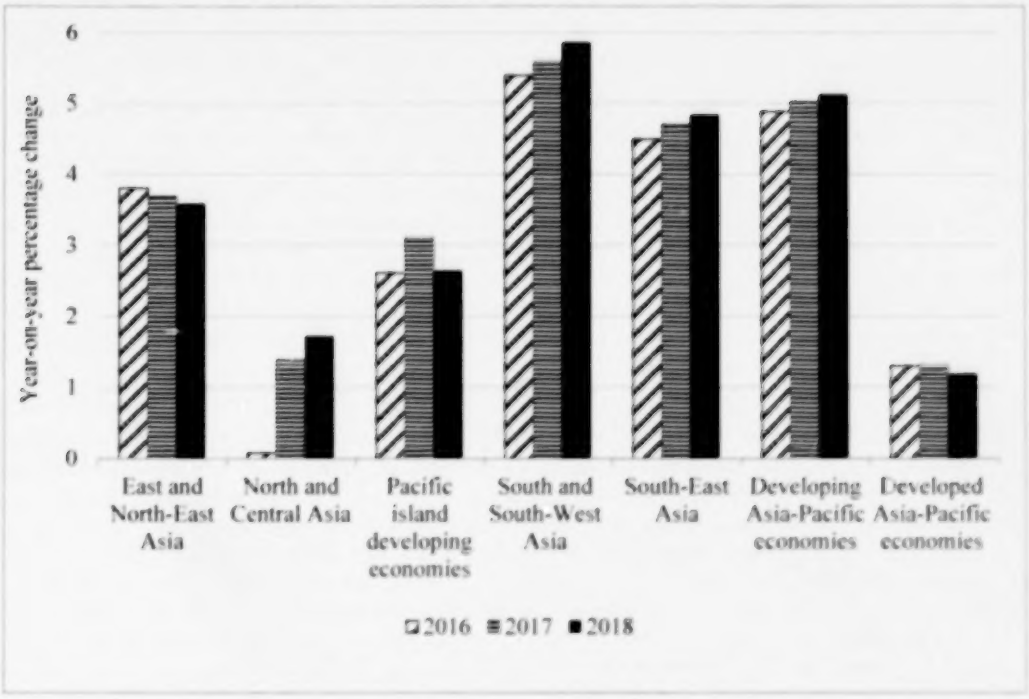
7. Economic growth in the Asia-Pacific region has relied more on domestic demand in recent years, but the boost from low inflation and accommodative policy stances has been smaller than expected. Possible reasons include relatively weak growth in real wages and farm incomes on the consumption side, and uncertainty and excess capacity on the investment side. In some countries, private sector debt overhang was also a major factor. In particular, private investment has not been forthcoming in many countries, which has undermined expansion of decent jobs. Leading indicators such as manufacturing Purchasing Managers Index and the latest export and import data do point to a mild economic recovery in 2017 and 2018. However, this is unlikely to be a firm rebound given that the factors that held back domestic demand remain largely unresolved even as rising trade protectionism effectively offsets potential recovery in external demand.

8. Average economic growth in developing Asia-Pacific economies is projected to rise to 5 per cent in 2017 and 5.1 per cent in 2018, from an estimated 4.9 per cent in 2016 (see figure I). In 2016, stronger than expected economic performance in China and the Russian Federation was offset by considerable slowdowns in India and Turkey. A modest but steady economic outlook for 2017 and 2018 is underpinned by the region's largest economy, China, where higher-value-added sectors are gradually replacing excess-capacity sectors as the driver of output, employment and export growth. A slightly improved economic growth outlook for the rest of the region is facilitated by a recovery in net commodity exporters and public investment in some of the net commodity importers.

9. In East and North-East Asia, economic growth was stable at 3.8 per cent in 2016, though lower than an average growth of 4.6 per cent experienced during the period 2011-2013. The main reason for this slowdown is moderation in economic growth in China in recent years amid structural reforms towards household consumption and services. Economic conditions, however, are broadly stable in China. The steady subregional growth in 2016 is underpinned by a slight economic rebound in Japan and the Republic of Korea, where domestic demand, particularly infrastructure projects and residential construction, has been the main economic growth driver.

10. The near-term economic prospects are stable, with projected output growth of 3.6 to 3.7 per cent in 2017 and 2018. A gradual downward growth trend in China is likely to continue, mostly reflecting ongoing efforts to curb rapid credit growth. An economic uptick in other large subregional economies should sustain the overall economic expansion. As an export-led subregion, a key downside risk is uncertainty over the strength of global trade. An immediate policy challenge is to tackle rising debt burdens while maintaining steady economic growth momentum.

Figure I
Economic growth in the Asia-Pacific region



Source: Economic and Social Commission for Asia and the Pacific (ESCAP), based on: national sources; *World Economic Situation and Prospects 2017* (United Nations publication, Sales No. E.17.II.C.2); International Monetary Fund, International Financial Statistics databases, available from http://elibrary-data.imf.org (accessed 1 February 2017); Asian Development Bank, *Asian Development Outlook 2016: Asia's Potential Growth* and updates (Manila, 2016); and www.ceicdata.com.

***Note*: Data for 2016 are estimates and data for 2017 and 2018 are forecasts. Developed Asia-Pacific economies comprise Australia, Japan and New Zealand**

11. In North and Central Asia, output in 2016 expanded by only 0.1 per cent, though this was much more positive than the 2.7 per cent contraction in 2015. Despite the recovery, subdued global energy prices continue to put pressure on this commodity-dependent subregion. In the Russian Federation, which accounts for about 80 per cent of the subregion's output, the recession was also driven by international sanctions and domestic structural impediments. Similarly, Azerbaijan and Kazakhstan recorded much weaker economic conditions, as sharp currency depreciations in late 2015 pushed up inflation, raised corporate debt burden, and triggered fiscal consolidation. The subregion is expected to experience moderate economic expansion of around 1.4 to 1.7 per cent in 2017 and 2018. The outlook is highly uncertain and contingent upon a further pickup in global energy prices, steady commodity import demand in China and stable geopolitical conditions in the subregion.

12. The Pacific island developing economies experienced a sharp economic slowdown in 2016, with economic growth dipping to 2.6 per cent in 2016 from 6.2 to 7.1 per cent in the preceding two years. The economy of Papua New Guinea, accounting for 60 per cent of the group's output, slowed notably amid subdued prices of minerals. Despite the overall gloomy picture, output growth increased in about half of the subregional economies. The economic outlook is expected to improve slightly, with projected economic growth at 2.6 to 3.1 per cent in 2017 and

2018, aided by an uptick in global commodity prices, steady economic growth in key trading partners like Australia and New Zealand and continued infrastructure upgrades. A key downside factor is the persistent risk of natural disasters. Room for policy responses to adverse shocks is often limited, as public debt levels are already close to established thresholds for fiscal stability in several economies.

13. In South and South-West Asia, despite a slight deceleration in economic growth to 5.4 per cent in 2016, the subregion was the fastest growing in Asia and the Pacific. In India, which accounts for at least half of the subregion's output, economic growth slowed amid weak manufacturing activity and fixed investment. An unexpected demonetization of currency also adversely affected India's economic performance. Economic growth also declined in Turkey as a result of heightened political uncertainty. In contrast, Bangladesh, the Islamic Republic of Iran and Maldives recorded stronger growth performance. Overall, consumer spending propelled economic activity, supported by multi-year low inflation and favourable employment conditions.

14. Output growth is expected to increase further to 5.6 to 5.9 per cent in 2017 and 2018. Private consumption, as well as public investment in some countries, will be the main growth driver. In India, the disruptive impacts of demonetization are likely to be temporary and economic growth is projected to gradually regain momentum. A key downside risk is higher than expected inflation, which could lead to monetary policy tightening and dampen consumer spending. Despite the positive near-term prospects, the subregion's economic development is constrained by inadequate infrastructure and energy. Closing such gaps requires large fiscal spending, which calls for policy tax reforms to restructure state-owned enterprises, expand the tax base and improve tax administration.

15. In South-East Asia, economic growth of 4.5 per cent in 2016 was on a par with that in 2014 and 2015. Indonesia, Thailand and the Philippines registered higher economic growth in 2016, driven by consumer spending and public infrastructure investment. In contrast, Malaysia and Singapore recorded multi-year low economic expansion amid subdued global trade. As in past years, economic expansion in less developed economies of the subregion – namely Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam – was more rapid than in emerging economies in the subregion amid robust manufactured exports and higher foreign direct investment inflows.

16. The economic growth outlook is projected to improve slightly to 4.7 to 4.8 per cent in 2017 and 2018. Supportive macroeconomic policies and low inflation are likely to back household consumption, although the magnitude of the impact may be held back owing to high household debts in some subregional economies. Private investment is expected to remain sluggish amid large spare production capacity and cautious investor sentiments. Key downside risks are possible delays on public investment projects and sluggish import demand in China.

B. Risks to the region's economic outlook

17. Despite a modest uptick expected in most subregions, the overall risks to the economic growth outlook of the region are tilted to the downside. This reflects a significant increase in policy uncertainty at the global level in recent months. The most significant risk is trade protectionism. There has already been a noticeable surge in the number of restrictive trade measures adopted both globally and regionally, as highlighted in the *Asia-Pacific Trade and Investment Report 2016: Recent Trends and Developments*.

18. Recent shifts in policy in the United States of America over trade, currency, immigration and other areas could have further negative impacts on the region, including for goods exports from China and services exports from India. Possible shifts in policy in the United States, together with Brexit and upcoming elections in some European economies, have also resulted in heightened global uncertainty, which undermines investment in the region. Any forgone trade and investment could in turn hurt employment prospects and drag productivity growth in the years to come. An ESCAP analysis suggests that economic growth in 2017 could be up to 1.2 percentage points slower than the baseline projections if an increase in trade protectionism and global economic uncertainty is steeper than anticipated.

19. This comes at a time of potential tightening of global financial conditions, influenced by gradual increase in United States policy rate on the back of better economic data. In effect, this could bring the region's monetary easing cycle to an end. Capital outflow pressures, which increased in the wake of elections in the United States in November 2016 before subsiding recently, are likely to re-emerge with the announcement of United States fiscal stimulus, and lead to further depreciation of regional currencies. Countries in the region with large current account deficits or high short-term external debt, such as India, Indonesia, Malaysia and Turkey, are particularly vulnerable. On the upside, regional exports may benefit from relatively stronger external demand and currency-induced competitiveness, but any boost is likely to be limited owing to the high number of trade protectionist measures.

20. While global commodity prices have largely stabilized over the last couple of years, it remains a source of upside or downside risk depending on whether a country is a net commodity exporter or importer. For instance, if global oil prices overshoot baseline projections of $52 to $55 per barrel, net importers in the region would face higher inflation but net exporters would see faster economic recovery.

21. Within the region, the role of China as originator and transmitter of shocks has increased in recent years. Real or perceived economic instability in China could lead to bouts of financial volatility in the region, as witnessed in early 2016. Given that several regional economies are competing with China in global value chains, the depreciation of the renminbi puts pressure on other regional currencies to also depreciate. On the upside, if economic performance in China is stronger than expected as in 2016, there could be positive trade spillovers.

22. In the medium term, strengthening domestic and regional demand will be critical against a difficult external environment. The rebalancing and opening up of China augurs well for the region in this regard. Initiatives such as the Belt and Road Initiative of China could provide renewed momentum to regional connectivity and intraregional trade, while capital account liberalization in China could dramatically increase the pool of long-term financing available for investments in the region. The future of regional demand also depends largely on whether South Asia realizes its full potential, towards which regional economic cooperation and integration could critically complement domestic efforts.

III. Economic policy considerations

A. Limited monetary policy space

23. Monetary policy stances in the region recently shifted from accommodative to neutral as upside risks to inflation increased slightly. In the first two months of 2017, policy interest rates were on hold in India, Indonesia and the Philippines while short-term interest rates were increased in China. This trend is in contrast to

the previous two years, when policy rates were lowered consecutively or kept at record low levels in these economies plus others such as Pakistan, the Republic of Korea and Thailand. Average inflation in developing Asia-Pacific economies is projected to rise from 3.6 per cent in 2016 to 3.8 per cent in 2017 and 2018. The uptick is more evident if the average excludes North and Central Asia, where inflation has been subsiding after large currency depreciations prompted high inflation in the previous two years.

24. Low policy rates have had a relatively limited impact on domestic demand and thus inflation, indicating limited monetary policy space. The recent uptick in inflation, though mostly due to non-domestic demand factors such as oil prices and exchange rate depreciations, also calls for caution. Likely currency depreciations could further limit monetary policy space, not least owing to its inflationary impact. Nevertheless, raising policy rates would be difficult as well. For instance, leveraged households and firms could find debt service costs rise and refinancing harder, increasing financial stability risks. Thus, economies are advised to maintain the status quo in terms of policy interest rates. At the same time, they should consider strengthening capital flows management and macroprudential measures to mitigate the adverse effects of exchange rate depreciations and to ensure financial stability.

B. Need for a proactive fiscal policy

25. Fiscal policy could play an active role in boosting domestic demand and supporting development priorities, such as reducing poverty, mitigating inequalities and supporting social protection measures. However, its effectiveness depends critically on better and effective governance. Fiscal policy stances in the region have been broadly countercyclical and expansionary in recent years. China implemented large infrastructure projects and tax breaks, India adjusted its medium-term fiscal consolidation path to accommodate higher current expenditures, and the Republic of Korea and Thailand engaged in various stimulus measures. However, net commodity exporters have taken a more cautious approach given terms of trade losses that have affected public finances.

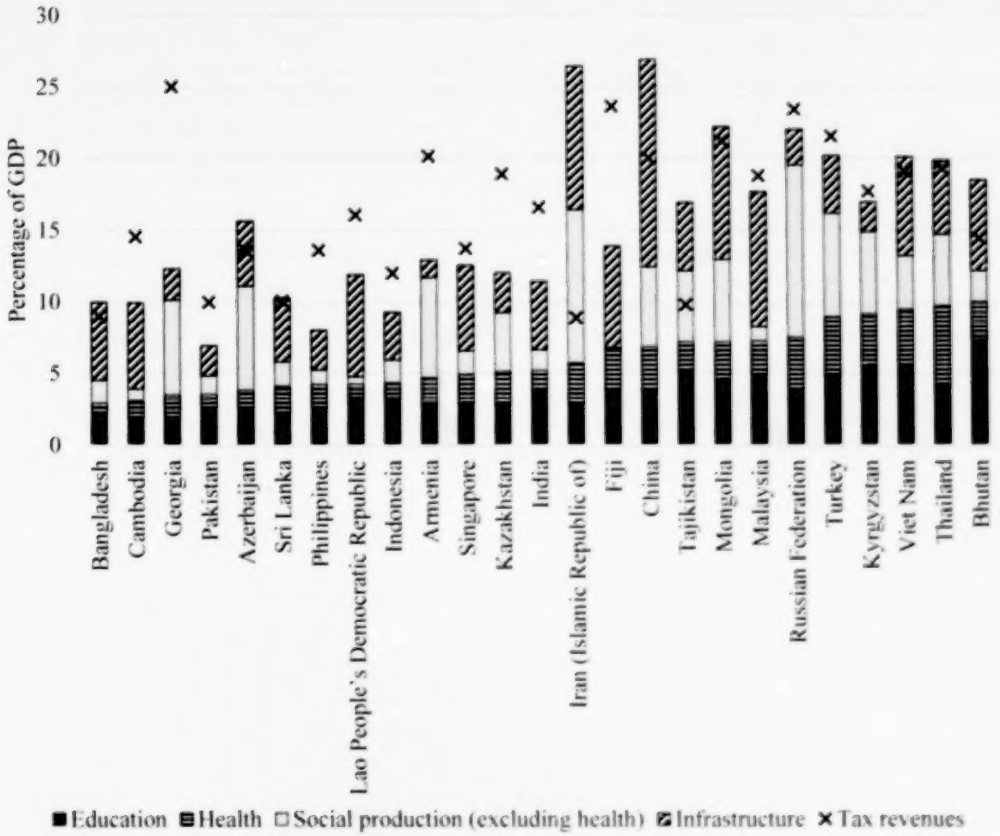
26. Beyond stabilization considerations, there have also been efforts to enhance the composition and quality of public expenditures in support of development priorities. Social spending on education, health and social protection have generally been on the rise, albeit gradually and from a low base, while a number of countries have ambitious infrastructure plans (see figure II). Beyond financing, countries need to pursue broader public sector governance reforms to ensure that spending translates into better development outcomes.

27. Ensuring fiscal sustainability would require tax reforms and effective debt management. Tax collection remains relatively low in the Asia-Pacific region, and the scope for boosting revenues through improved compliance and base-broadening is particularly large. In countries where domestic demand is depressed, some tax relief could be offset by debt finance, taking advantage of the relatively low government bond yields in recent years, although the window of opportunity here may be narrowing.

28. In assessing fiscal sustainability, countries should consider the potential long-term positive spillover effects of social and infrastructure investments on the economy. If the spillovers are sufficiently large, for instance owing to the crowding-in of private investment, ratio of public debt to gross domestic product (GDP) could be stable over the long term. This is an area where more research is needed given mixed empirical evidence. At the same time, expenditure efficiency and revenue enhancement efforts – aspects influenced by better governance – could help contain

the primary balance and make debt dynamics less sensitive to the interest rate-nominal GDP growth differential.

Figure II
General government expenditures and revenue



Source: International Monetary Fund (IMF), Fiscal Monitor Database (available from www.imf.org/external/pubs/ft/fm/2011/02/app/FiscalMonitoring.html; accessed 1 February 2017); IMF, World Economic Outlook Database (available from www.imf.org/external/pubs/ft/weo/2016/02/weodata/index.aspx; accessed 1 February 2017); IMF, Investment and Capital Stock Dataset (available from www.imf.org/external/np/fad/publicinvestment/data/data.xlsx; accessed 1 February 2017); United Nations Educational, Scientific and Cultural Organization Institute for Statistics database (available from http://uis.unesco.org/; accessed 1 February 2017); World Bank, World Development Indicators database (available from http://data.worldbank.org/data-catalog/world-development-indicators; accessed 1 February 2017).

29. The important role of fiscal policy management in promoting social development is evident in Pacific island developing economies. Evidence suggests that current relatively large health spending in the Pacific subregion could be made more effective if more resources were devoted to preventive care and early treatments by specialized health services. Regarding revenue policy, taxes and tariffs have been introduced to discourage consumption of unhealthy products, although there appears to be room for higher tax rates. Policies such as user-pay health-care services and public-private partnerships are also a possible option, but they require careful implementation and effective governance to ensure access to services.

C. Importance of structural reforms

30. Structural reforms could complement monetary and fiscal policies and help lift productivity and potential growth, but sufficient attention must be paid to their distributional impacts. Interest in structural reforms has increased in recent policy discussions, although no definition has been agreed upon. They generally refer to policy, legislative and regulatory changes that increase the efficiency of factor markets (land, labour and capital) and product markets. Recent examples from the region include liberalization of interest rates in China and the new national bankruptcy law in India, which are expected to support private investment. Careful assessment is needed of the distributional and environmental impacts of such growth-enhancing reforms, so that appropriate compensating measures may be introduced. Such reforms could also go beyond the GDP measure as a benchmark to incorporate social and environmental considerations that affect social welfare.

31. In many cases, the driving force for implementing domestic structural reforms is new opportunities brought about by external developments. For example, in North and Central Asia, the Eurasian Economic Union aspires to be a single market with free trade among members, while the Belt and Road Initiative of China aims to improve trade and infrastructure connectivity between China and Europe through the Eurasian land mass. To capitalize on the potential gains from the Eurasian Economic Union and the Belt and Road Initiative, the subregional economies need to reduce domestic regulatory burden, thus enabling firms to benefit from lower cross-border trade costs. As productive capacity increases, more active participation in global supply chains can help widen the subregion's economic base.

IV. Enhancing the quality of economic growth

32. In addition to ensuring sustained and robust economic growth, policymakers will need to address some key social and environmental challenges in order to improve the quality of this growth. In the 2017 *Survey*, after a discussion of recent developments in the region with respect to the labour market, poverty and inequality, there follows an examination of recent trends in social protection and resources efficiency in the Asia-Pacific region as selected topics.

A. Creating decent jobs for poverty reduction and equitable growth

33. Expansion of decent jobs remains a challenge. In 2016, average employment growth in the Asia-Pacific region was modest but remained steady at 1.1 per cent, while the share of vulnerable employment remained persistently high at about 50 per cent. Based on official labour statistics from the past year, few countries seem to have made progress on both quantity and quality (for example, the Philippines), with some succeeding only on quantity (Indonesia) or quality (Thailand, Viet Nam) and others lacking progress on either front (Sri Lanka).

34. In China, the labour market continues to adjust to structural rebalancing in the economy. In India, demonetization has created short-term uncertainty in labour markets, but could help address informality in the longer term. Across the region, some improvement was made in lowering unemployment, although youth still face disadvantages. In 2015 (latest data), real wages growth was relatively robust in South Asia, possibility due to disinflation, and in China, where the share of labour in national income has been recovering.

35. The benefits of economic expansion have accrued relatively less for poor people, as evident from rising income inequality. Sustained poverty reduction in the

context of slower economic growth would need to rely more on enhancing income distribution and addressing non-income factors such as social exclusion. However, income inequality has increased or remains high in many countries, with a significant concentration of wealth at the top. Wide income inequality also undermines social cohesion and hurts long-term economic growth by reinforcing inequality of opportunities.

36. Comprehensive measures are needed to tackle inequality, including labour market policies such as minimum wages and training of low-skilled workers, and fiscal measures such as progressive taxation and social assistance. For example, to tackle rising inequality and high poverty in South and South-West Asia, availability of decent and high-productivity jobs will be a crucial factor, as most households depend entirely on labour income for their living. There is also a need to reduce the prevalence of informal jobs, which typically have low pay and limited social protection. In this regard, more effort is needed to create new high-productivity sectors, as well as to increase value added for existing economic activities, including the agricultural sector.

37. The economic formalization process would benefit from the streamlining of paperwork requirements and linking of incentive schemes, such as financial support, with business registration and basic compliance with labour regulations. Governments could also provide more support to informal workers, including by delinking social security benefits from employees' contributions. All such efforts would require focus on improving various elements of governance.

B. Expanding social protection financing and coverage

38. A robust system of social protection can ensure that no one is left behind, and contribute to strengthening domestic demand in a more equitable and durable manner. Key aspects of a social protection floor include universal access to affordable health care, free primary and secondary education, unemployment benefits for wage earners and income-support measures for those in need, contributory and social pensions, and full access to social benefits for persons with disabilities.

39. Aside from fulfilling people's rights, greater social protection can help strengthen domestic demand by reducing precautionary savings, so that poor people can consume adequately and also invest in higher-return livelihood strategies. Social protection can also improve the functioning of labour markets by facilitating skills development and employment, which is especially important in economies that are undergoing rapid structural changes.

40. The Asia-Pacific region is currently falling behind the rest of the world in terms of social protection financing and coverage, although there are some successful examples in the region. Average total expenditures, including on social insurance, social assistance and labour market programmes, stand at 5.3 per cent of GDP in the region, compared with the world average of 8.6 per cent. Effective coverage of social protection is limited; in the case of unemployment benefits (contributory and no-contributory), for instance, it is limited to 7 per cent of the labour force in the region, compared to the world average of 12 per cent. In particular, expanding coverage to the large informal sector remains a challenge, although countries such as China and Thailand have been able to successfully establish universal health care and pension schemes through a combination of contributory and non-contributory schemes. There have also been innovative approaches to expanding coverage, such as employment injury insurance in Bangladesh and Malaysia and the rural employment guarantee in India.

41. The development of social protection floors is a multi-step process that includes a national social dialogue, financing strategy and delivery mechanisms. As with public goods in general, social protection is a matter of political choice which requires sufficient national dialogue. This is especially the case for developing national floors and universal schemes, which a growing number of countries are considering. Successful country experiences, as well as simulation exercises, show that universal schemes can be affordable.

42. Options to finance social protection schemes include budget reallocation, such as phasing out untargeted subsidies and containing wage bills; expenditure efficiency, such as direct benefit transfer; pension and health system reforms, such as increasing incentives to use community-based health services; and revenue enhancement. Coverage could be expanded progressively, as was done in China for the rural population and then the uninsured part of the urban population. Synergies should be sought, for instance, by strengthening public health infrastructure through public employment programmes. Labour market programmes, although less widely used in the region, could enhance the economic growth impact of social protection.

C. Internalizing the costs of environmental degradation

43. Although not captured in the GDP measure, environmental degradation and carbon emissions reduce social welfare and undermine the sustainability of economies. Air pollution is now the world's fourth leading fatal health risk, causing one in ten deaths in 2013; in a recent study, the associated welfare loss is estimated at about $5 trillion. Even with continued efficiency gains, global carbon emissions are projected to rise by 13 per cent by 2035 in the base case, which is far in excess of the 30 per cent reduction required to achieve the goals set out in the Paris Agreement. Unplanned urban expansion and conversion of agriculture, forests, wetlands and other ecosystems have also increased vulnerability to natural disasters and the impacts of climate change. At the global level, climate change is now a grave threat to humanity.

44. The region's rapid economic growth in the past few decades was achieved, in part, on the back of environmental degradation with concomitant health impacts, and intensive and inefficient use of resources and natural wealth. The region is highly vulnerable to climate change, the adverse effects of which can substantially undermine the economic development gains in the region and could force more than 100 million people from the region into extreme poverty by 2030. Clean air, safe drinking water, sufficient food and secure shelter – key determinants of health – are also being adversely affected.

45. Despite gradual improvements, the region falls behind the rest of the world on energy and carbon intensity levels. On average, developing Asia-Pacific economies use twice as many resources per dollar of GDP as the rest of the world. Despite steady reductions since the 1990s, the region's energy and carbon intensity levels of production remain relatively high. With the region's growing weight in the global economy, this has meant that the region's share of global energy consumption and greenhouse gas emissions has also increased despite improvements per dollar of GDP. Albeit from a low base, per capita consumption and emission levels have steadily increased and are now on a par with the rest of the world.

46. A mix of regulatory, market-based, and voluntary and information-based policy instruments can be used to address environmental imbalances. Compared to regulations, economic instruments that rely on prices or markets to function are less information-intensive and have superior allocative efficiency, but they can exert less control over the actual environmental outcome. They include taxes, subsidies and

emissions trading systems. Voluntary and information-based measures, such as eco-labels and corporate sustainability reporting, have relatively low implementation costs but could have limited sectoral coverage.

47. A clear example of policy effort to achieve more environmentally friendly economic growth is in East and North-East Asia. After years of heavy industrialization which led to deteriorating environmental conditions, the subregion is now focusing on green growth and developing energy-efficient and renewable technologies. Together, China and Japan account for nearly half of the world's commercial investments in clean technology, while China accounts for most of the world's patent filings in climate change mitigation technologies.

48. Experiences from the subregion point to three desirable aspects of public policies to promote clean energy, all of which highlight the important role of effective governance. The first dimension is a well-designed governance structure that features a whole-of-government approach, effective monitoring and evaluation mechanisms, and multi-stakeholder partnerships from development to diffusion of technology. The second aspect is a balanced policy framework in which Governments consider a mix of incentives, such as favourable pricing of renewable energy, and regulations, such as the setting of minimum energy-efficiency standards. The third dimension is an enabling financing system, particularly non-traditional, green financing instruments such as carbon trading and green bonds.

V. Governance, fiscal management and development outcomes

A. Governance and development outcomes

49. According to the worldwide governance indicators, a marginal improvement in institutional quality has been observed, on average, in the Asia-Pacific region over the past two decades. This trend primarily reflects improvements in East and North-East Asia and in landlocked developing countries, particularly in North and Central Asia. These improvements can be explained by the general increase in income levels, and the demand for better institutions that results from a rise in the middle class and a better-educated population. Furthermore, amendments to laws and regulations as well as their implementation have played a critical role in changing the perceived quality of governance.

50. As shown in the 2017 *Survey*, better governance and effective institutions affect all three aspects of sustainable development. For instance, in terms of economic outcomes, governance affects the capacities of an economy to have access to a skilled labour force, improve investment prospects and sustain innovation. All these factors in turn help enhance the level and pace of productivity, thus improving the long-term economic prospects of an economy.

51. When institutions are weak, inequalities tend to increase and the pace of poverty reduction declines. The main issues discussed in the 2017 *Survey* are misallocation of resources and market inefficiencies; a less progressive tax system that favours well-connected people and high-income households; and greater difficulties for low-income households to borrow because of weak enforcement of rules. Weak institutions also partially explain inequality in access to social services, particularly for women as well as for the poorest and most vulnerable segments of the society.

52. The quality of governance is also important for environmental outcomes, as reflected, for instance, in varying capacities to make and apply environmental rules and safeguards. At the same time, good governance can foster ecological innovation

and technological transfer which positively contribute to the reduction of environmental degradation, as seen in the earlier example of East and North-East Asia.

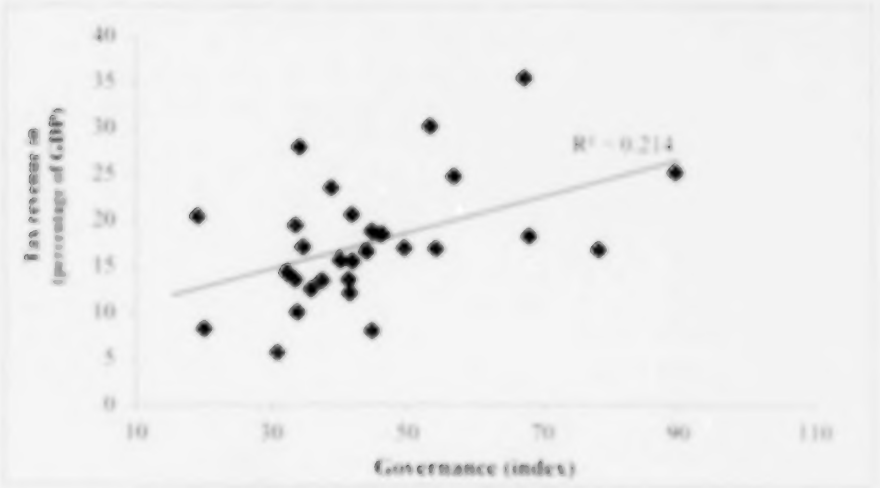
53. Effective governance can also help close development gaps across countries by contributing to the success of reforms that allow poorer countries to benefit more from regional economic integration. In South-East Asia, the average income per capita in emerging economies is over 10 times that of Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam. Development gaps in terms of education and health outcomes are also notable. Narrowing such gaps is important because it would better help Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam to fully realize the potential gains of the Association of Southeast Asian Nations Economic Community. Among other areas, structural reforms aimed at enhancing public infrastructure, labour skills and social protection in Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam are key to closing the development gap.

54. The necessary conditions for the successful implementation of these reforms are effective economic governance and strong institutional quality. Various governance issues could be strengthened in Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam, such as the need to strengthen law enforcement, ensure property rights and increase judicial independence. Similarly, promoting greater use of the criminal justice system in addressing corruption, enhancing cross-ministerial coordination to avoid duplication of work and introducing more transparent business regulatory framework can go a long way to improving development outcomes in Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam.

B. Better governance to improve tax revenues and enhance public expenditure management

55. Weak governance partially explains the low level of tax revenues in several countries in the region (see figure III). This impact can be a result of high levels of corruption, which tends to reduce tax collection in relation to GDP and foster higher levels of tax evasion. Other factors that contribute to or encourage fiscal corruption include complicated tax laws; excessive discretionary power vested in tax administrators and the necessity for frequent interactions between taxpayers and tax officials; weak legal and judicial systems; lack of accountability and transparency in tax administration; and low salaries in the public sector.

Figure III
Governance and tax revenues in Asia-Pacific countries



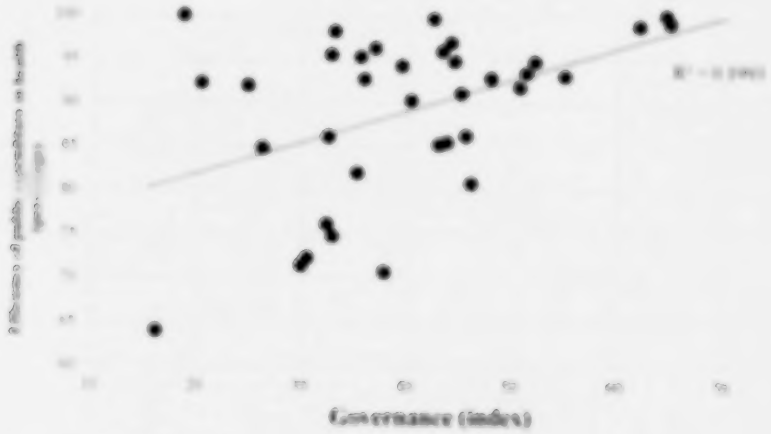
Source: ESCAP, based on data from World Bank, World Development Indicators database (accessed 15 November 2016) and World Bank, Worldwide Governance Indicators (available from http://info.worldbank.org/governance/wgi/index.aspx#home, accessed 15 November 2016).

96. Governance also impacts the way public revenues are raised by affecting tax morale, as the willingness to pay taxes is affected by perceptions of how well tax revenues are used. Thus, while taxpayers will generally be willing to pay taxes if they perceive that the level of public services that is offered is commensurate to their tax bills, taxpayers will shirk their tax responsibilities if they see a mismatch between tax liabilities and services. Low tax morale may also be linked to the perception that evasion of taxes is widespread, especially among those with higher incomes. The 2017 Survey contains an estimate that a decline in governance indicator scores explains up to 8 per cent and 21 per cent of the decline in tax revenues in Pakistan and Bhutan respectively from 2005 to 2014.

97. The quality of governance also affects the achievement of development goals through its impact on the composition and efficiency of public expenditure. For instance, corruption has been shown to distort the structure of public spending by reducing the portion of social expenditure that goes on education, health and social protection. In contrast, better governance has been found to increase the impact of public health spending on child mortality rates (see figure IV), as well as making public spending on primary education more effective and leading to higher attainment in primary education.

Figure IV

Governance and public expenditure efficiency in the health sector in Asia-Pacific countries



Source: E/ESCAP/73/INF/2, based on data envelopment analysis of variables retrieved from the World Development Indicators database (accessed 15 November 2016).

Note: Efficiency scores are based on the comparison between actual input (public expenditures) and theoretical input that should be used to obtain the same level of output (health outcomes).

58. Moreover, less social expenditure also usually goes hand in hand with greater expenditure on items such as law and order, fuel and energy subsidies, and defence. The 2017 Survey contains an estimate that between 2005 and 2014, the impact of better governance and effective implementation of policies on public sector efficiency ranged between 0.34 per cent in the Russian Federation and 57 per cent in Georgia in the health sector, and between 0.15 per cent in Timor-Leste and 32 per cent in Indonesia in the education sector.

C. Policies to improve governance for better fiscal management

59. Improving transparency and accountability in public administration is the key to better fiscal management. As argued in the 2017 Survey, transparency and accountability can be improved and strengthened by ensuring the production of and access to key data and information, developing governmental mechanisms related to monitoring, evaluating and auditing policies and actions, and creating inclusive institutions where public service beneficiaries can exchange views with the Government. Using e-government tools, promoting decentralization and reforming tax and expenditure policies can also contribute to the implementation of these activities as a means of improving transparency and accountability.

60. A regional assessment suggests that several Asia-Pacific countries require public officials at different levels to declare their financial assets to help increase the integrity of civil servants as well as public trust in them. This has improved the efficiency of government expenditures and the overall quality of governance, though further improvements are needed in public access to and coverage of pertinent information, as well as in monitoring and oversight of implementation of such policies.

61. Ensuring access to meaningful fiscal information contributes to greater transparency. However, information on the availability of resources received by the

various government units responsible for the delivery of public services and public access to key fiscal information remain difficult in several countries in the region, even though these policies have yielded positive results in the cases of Georgia, the Republic of Korea, Samoa and Singapore. Furthermore, when information is published, the quality and utility of the published government financial data seems to be low, particularly in North and Central Asia. Besides producing and disseminating information, government officials will also need to better manage operational risks associated with the execution of the budget, whether related to tax revenues or expenditure, through internal controls and audits and external audits.

62. An assessment of public financial management in selected Asia-Pacific countries shows that there is considerable room to strengthen internal controls and external and internal audit functions. For instance, Public Expenditure and Financial Accountability assessments show that, in several countries, there are issues related to the comprehensiveness, relevance and understanding of internal control rules and procedures. Similarly, the degree of compliance with rules for processing and recording transactions is weak. Concerning internal audit, Asia-Pacific countries face concerns related to the frequency and distribution of reports, and the extent to which management follows recommendations from internal audits. Lastly, concerning external audits, the major concerns are the scope of external audit, adherence to international standards and the timeliness of submission of reports.

63. In addition to audit and control functions within the public administration, the integration of the views and concerns of citizens is important as it allows the effectiveness of a policy to be checked and tax morale and revenues to be raised. Enhancing transparency and strengthening accountability requires effective feedback systems to be established, through which users are informed of the existence of such tools and are able to report wrongdoing by officials or assess the quality of public services.

64. The implementation of the above-mentioned policies can be optimized through information and communications technology and through a wider use of financial products by beneficiaries of public services and taxpayers. Tax revenues can substantially increase through deployment of an e-system for tax return and tax filing. Public expenditure efficiency can also increase through e-systems because government programmes can be better coordinated, such as in Malaysia with the eKasih system, or funds can be tracked up to the final beneficiary, such as in India with the payment of social benefits or wages through bank accounts. While e-government systems present opportunities for public financial management and progress has been made during the last decade, Asia-Pacific countries could take greater advantage of those opportunities. Overall, countries with special needs (least developed countries and landlocked developing countries), which face governance issues, do not tend to use e-government platforms even though they could benefit greatly from their usage.

65. Efforts are needed to improve information flows across relevant government departments. For instance, the tax-enforcement function depends on a central database and flow of information from different sources, particularly in the case of value added tax and income taxes. However, a typical approach in the organization of tax administrations in developing countries has been to establish separate revenue departments overseeing different tax bases. This results in little information-sharing among the departments and difficulties in reconciling data and information on taxpayers. Some countries, such as Maldives and the Philippines, have addressed this problem by reorganizing the tax administration along functional lines.

66. Through greater ownership of local revenues, fiscal decentralization can strengthen accountability and improve the efficiency of public expenditure.

However, at the subnational level, gap-filling transfers and shared revenues are preferred to own-source revenues in several Asia-Pacific economies. Measures such as control over rate structures at the local level could be more effective in generating accountability, even if all or some elements of tax administration are managed at a different level. Given more limited capacities, subnational administrations could also consider adopting piggyback taxation, whereby tax revenues are collected using the tax base identified by the central Government and a surcharge is added to the tax rate. Accountability could also be improved by using a property tax system that accounts for the size and location of the property and the cost of public services delivered.

VI. Concluding remarks

67. How societies invest, innovate and ensure that no one is left behind is largely dependent on the quality of governance, or on how much trust and confidence people have in their institutions. As countries in Asia and the Pacific continue to undergo extensive structural transformation, as reflected in the ongoing rebalancing in China and reforms in India, the role of governance will only increase. In the 2017 *Survey*, the issue of governance is examined in the specific context of fiscal management, given the growing demands on fiscal policy to support the economy and address diverse social and environmental challenges.

68. Examples of countries in the region that have successfully scaled up infrastructure outlays, expanded social protection coverage and enhanced the efficiency of resources all point to the importance of good governance and effective fiscal management. Medium-term challenges facing different subregions, such as economic diversification in North and Central Asia, also call for better governance. Moreover, although not touched upon in this document, another dimension of governance – that is, trust and confidence among countries in Asia and the Pacific – will be critical for advancing regional economic cooperation and integration and sustaining the region's dynamism against a difficult external environment.